Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review	)	
for Local Exchange Carriers	)	CC Docket No. 94-1

INTERMEDIA COMMUNICATIONS OF FLORIDA, INC.
COMMENTS IN TRIENNIAL REVIEW OF PRICE CAP REGULATION FOR LOCAL EXCHANGE CARRIERS

Intermedia Communications of Florida, Inc. ("ICI"), by its undersigned counsel, and in response to the Notice of Proposed Rulemaking ("NPRM") released in the above-captioned docketed proceeding,[1/] hereby submits its comments on the impact of the Commission's Price Cap rules during their first three years. As ICI discusses below, trends in local exchange carrier ("LEC") rates demonstrate that the Price Cap rules have not been successful in achieving the Commission's stated goals of promoting competition and stability in LEC rates. ICI respectfully requests that the Commission modify the Price Cap rules to provide more effective protection against unreasonably discriminatory and anticompetitive LEC costing and pricing practices.

I. RESPONSE TO GENERAL ISSUE 1: THE PRICE CAP RULES MUST BE MODIFIED IN ORDER TO ACHIEVE THE COMMISSION'S STATED PUBLIC POLICY GOALS

When the Commission promulgated its Price Cap rules, it stated as a central policy objective the desire to provide LECs with reasonable pricing flexibility while promoting stability in LEC service rates: "By limiting the amount of pricing

1/ Price Cap Performance Review for Local Exchange Carriers, 9 FCC Rcd 1687 (1994) ("NPRM").

flexibility a LEC can exercise, we can ensure that rates will remain relatively constant from one period to the next, moving only incrementally."[2] The Commission also stressed the need to protect competitors against unreasonable LEC pricing practices: "[O]ur decision not to streamline price cuts below a certain level, and to require more detailed cost information for those price cuts, is testimony to our commitment to police any LEC attempts to engage in predation or cross-subsidization."[3] These goals remain critically important to the development of competitive markets for local telecommunications services, and should not be changed. As ICI discusses below, however, Price Caps to date have not been effective in promoting these goals, and they must be re-emphasized through amendments to the Price Cap rules.

Despite the Commission's stated commitment to procompetitive rate stability, the first three years of Price Cap regulation have been marked by precipitous declines in LEC rates for services becoming subject to competition, without commensurate changes in noncompetive service rates. For example, between April 1991 and April 1994, GTOC-Florida reduced its rates for undiscounted[4] DS1 systems by 32-36%,[5] and reduced its rate elements for undiscounted DS3 transport by 30-

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2/ Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd 2176, 2290-91 (Supplemental NPRM)(1990).

3/ Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd 6786, 6791 (Final Order)(1990).

4/ "Undiscounted" circuits are single DS1 or DS3 circuits taken on a month-to-month basis. Multiple circuits taken for long-term commitments are eligible for volume and term discounts, which provide even greater rate reductions.

5/ Compare GTOC Tariff F.C.C. No. 1, Transmittal No. 711 at Workpaper SP 6 (issued Apr. 2, 1992) with Transmittal No. 867 at Workpaper TK 8 (issued Apr. 1, 1994).

58%.[6] During that same period, GTOC-Florida expanded the additional volume and term discounts available to its largest-volume DS3 customers to approximately 70%. As a result, GTOC-Florida now provides some of the largest volume and term discounts in the country. Similarly, during the first three years of Price Caps, BellSouth reduced base rates and introduced a term plan for DS1 service that reduced rates by approximately 20%, and expanded the maximum volume and term discounts available for its DS3 services from 50% to 73%. In contrast to these dramatic rate reductions for services becoming subject to competition, neither LEC evidenced reductions of such magnitude in services that were not subject to competition.

These extraordinary rate reductions over a three-year period demonstrate that the Price Cap rules have not been effective in promoting the stable, incremental rate movements that the Commission sought in designing those rules. Indeed, under the Price Cap rules, LECs have demonstrated virtually unlimited pricing flexibility for selected services in selected markets that are becoming subject to competition. The extreme rate fluctuations in LEC rates under Price Caps have proven to be a significant barrier to competitive entry, and raise substantial concerns over unlawful discrimination and cross-subsidization in LEC ratemaking practices. As ICI discusses below, the Commission should modify the Price Cap rules to address these concerns directly.

6/ Compare GTOC Transmittal No. 711 at Workpaper SP 7 with Transmittal No. 867 at Workpaper TK 10.

II. RESPONSE TO BASELINE ISSUE 2: THE COMMISSION MUST PROHIBIT DISCRIMINATION IN THE USE OF COSTING AND PRICING METHODOLOGIES AMONG SERVICES IN THE SAME BASKETS

During the first three years of Price Caps, LECs have demonstrated the ability and willingness to manipulate pricing and costing methodologies to achieve unreasonably discriminatory and anticompetitive results. Perhaps the most extreme example of such anticompetitive discrimination can be found in the LECs' proposed rates for expanded interconnection, which currently are being investigated by the Commission. Virtually all of the LECs employed fully distributed costing in setting rates for expanded interconnection.[7/] In contrast, these same LECs set their rates for the high capacity special access services against which CAPs are beginning to compete using incremental costing methodologies.[8/] Because use of FDC establishes higher rates than an incremental costing method,[9/] the LECs' manipulation of costing methodologies is a transparent attempt to impose upon competitors purchasing bottleneck LEC services costs that are excluded from services subject to competition. Not only does this manipulation of costs provide the LECs with an unfair competitive advantage, it violates Section 202(a) of the Communications Act by penalizing one

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7/ GTOC expressly stated its use of FDC in its expanded interconnection filing, GTE Telephone Operating Companies, Tariff F.C.C. No. 1, Transmittal No. 771, Description and Justification ("D&J") at 19 (issued April 1, 1992). Other LECs, such as BellSouth, did not specifically identify the costing methodology used, but the use of FDC is apparent through their inclusion of general overhead loadings.

8/ For example, when BellSouth introduced its SMARTRing service -- which is specifically designed to compete against the fiber-ring network-based service that ICI introduced to the Florida market -- BellSouth acknowledged the use of incremental costing in setting rates for the service. BellSouth Telecommunications, Inc., Tariff F.C.C. No. 1, Transmittal No. 402, D&J at A-1 (issued June 13, 1991).

9/ E.g., Southern Pacific Communications Co. v. AT&T, 556 F. Supp. 825, 923 (D.D.C. 1982).

class of LEC customers -- collocated competitors -- while providing preferential treatment to another -- customers with competitive service options.

Other examples of discriminatory ratemaking practices that have been established under the Price Cap rules abound. All LECs have established volume and term discounted rate structures for the DS1 and DS3 special access services that are becoming subject to competition, but no LEC provides volume or term discounts for the DS1 and DS3 cross-connects that collocated CAPs and other parties purchase through expanded interconnection. In 1992, GTE cut its rates for premium switched transport termination by 64% in Florida and 80% in California, but did not reduce rates for these elements in most of its other service areas.[10/] As a result of this selective rate decrease, rates for GTE switched termination in states such as Idaho and Montana -- where GTE faces no competition -- were set at levels as much as 600% higher than the rates for identical service in Florida. These examples make clear that, under the current Price Cap rules, LECs have unencumbered discretion to shift costs from selected services in competitive markets to captive monopoly ratepayers and competitors. ICI respectfully submits that the need to protect ratepayers and competitors from such patently discriminatory and anticompetitive practices is self-evident.

ICI recommends that the Commission incorporate into its Price Cap rules a broad prohibition against the discriminatory application of costing and pricing methodologies and rate structures for functionally similar services. Such a

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[10/] GTE Telephone Operating Companies, Tariff F.C.C. No. 1, Transmittal No. 771 (issued April 1, 1992).

requirement would apply to all services in a given service basket, and would require that LECs: (1) use FDC or incremental costing methods consistently, (2) use the same overhead loading factors for all rate elements, and (3) provide identical volume and term discounted rate structures for functionally similar services.

Such a broad-based prohibition of discrimination among services in the same basket would provide effective protection against LEC attempts to over-recover overhead costs from monopoly service ratepayers and competitors, and would ensure that all customers will benefit equally from legitimate rate reductions stemming from economies derived from new technology. Indeed, the Commission has already taken such a step in its pending investigation of the LECs' expanded interconnection rates. On November 12, 1993, the Commission prescribed, on an interim basis, overhead loading factors to be used in setting the rates for expanded interconnection. In doing so, the Commission prevented the LECs from employing overhead loadings greater than those used for other tariffed special access services.[11/] The approach recommended by ICI is fully consistent with this action. Moreover, it would leave the LECs with considerable pricing flexibility -- LECs would retain their ability to employ volume and term discounts and deaverage rates according to density zones. They simply would be denied the ability to manipulate their pricing and costing practices to discriminate against similarly situated classes of customers.

In addition, such a systemic approach to rate regulation would minimize the burden on the resources of the Commission, the LECs and interested parties. The

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11/ Local Exchange Carriers' Rates, Terms and Conditions for Expanded Interconnection for Special Access, 8 FCC Rcd 8344 (1993).

use of the broadly applicable antidiscrimination provisions recommended by ICI would require an initial revision of LEC rates to achieve compliance -- such rate revisions could be made during next year's annual access filing. Thereafter, LECs would be required to demonstrate compliance with the nondiscrimination provisions in filings that introduce new services or propose below- or above-band rate changes. Such a showing would be comparable to the cost data that LECs must now provide to support such filings.

III. RESPONSE TO BASELINE ISSUE 11: THE COMMISSION SHOULD REVISE ITS PRICE CAP RULES TO REPLACE THE AVERAGE VARIABLE COST TEST WITH A LONG-RUN INCREMENTAL COST STANDARD

When it promulgated its Price Cap rules, the Commission adopted an average variable cost ("AVC") test to determine whether below-band filings were reasonable.[12/] It adopted this standard in the face of considerable argument that AVC was not an appropriate cost standard, and that a long run incremental cost ("LRIC") analysis would be more appropriate. Since the inception of Price Caps, the Commission has used the AVC test to analyze the reasonableness of other rates as well.[13/]

Although the Commission has cited the AVC test in numerous orders, the test has never been defined in the context of a LEC tariff filing. Indeed, while several LEC below-band filings have been opposed by interested parties, the

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12/ Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd 6786, 6824 (1990).

13/ Letters from Common Carrier Bureau Chief Cheryl Tritt to John Litchfield (Ameritech), Michael McCullough (Bell Atlantic), A.E. Swan (Pacific Bell) and Glenn Brown (U S West), dated Dec. 18, 1992 (requesting AVC data in the Bureau's inquiry into existing volume and term discounted rates established by the four LECs).

Commission has not addressed substantive questions raised regarding the adequacy of the LECs' AVC cost data. Moreover, the Commission has never found any LEC rate to fail the AVC test, including the 64% and 80% switched transport rate reductions discussed in Section II, supra.

Intermedia posits that the AVC test established by the Price Cap rules is vague and virtually unenforceable. Moreover, the AVC test cannot guarantee against predatory pricing in an industry in which LECs provide a broad mix of monopoly and competitive services over networks comprised predominantly of commonly used facilities. Dr. Alfred Kahn notes that AVC is inappropriate in a multiproduct market in his treatise on the economics of regulation:

> Long-run marginal costs are likely to be the preferred criterion also in competitive situations. Permitting rate reductions to a lower level of SRMC [short-run marginal costs, for which AVC is a substitute], which would prove to be unremunerative if the business thus attracted were to continue over time, might constitute predatory competition -- driving out of business rivals whose long run costs of production might well be lower than those of the price-cutter.[14/]

A similar conclusion is extensively supported in a study commissioned by AT&T, MCI and CompTel:

> [Local telecommunications service] is characterized by extremely high fixed costs and low (or in some cases near-zero) variable costs . . . A short run marginal cost test is not particularly useful or applicable for industries characterized by low product-specific variable costs. In the case of local telephone service, most costs are in fact fixed over a broad range of output and mix of services, because the same fixed common

14/ 1 A. Kahn, The Economics of Regulation, 85 (1988) (emphasis in original).

stock of capital is used to produce a spectrum of services ranging from highly monopolistic to highly competitive.[15]

In light of these analyses, ICI urges the Commission to adopt long run incremental cost as the appropriate standard for analyzing below-band filings, as well as other LEC pricing practices that raise concerns over predation and unlawful cross-subsidy.

IV. CONCLUSION

For the reasons discussed above, and in light of LEC pricing practices evidenced during the first three years of Price Cap regulation, ICI respectfully requests that the Commission modify its Price Cap rules in accordance with the recommendations contained herein.

Respectfully submitted,

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[15] Economics and Technology, Inc./Hatfield Associates, Inc., The Enduring Local Bottleneck, 188 (1994).

<u>CERTIFICATE OF SERVICE</u>

I hereby certify that on this 9th day of May, copies of the foregoing INTERMEDIA COMMUNICATIONS OF FLORIDA, INC. COMMENTS IN TRIENNIAL REVIEW OF PRICE CAP REGULATION FOR LOCAL EXCHANGE CARRIERS have been sent via hand-delivery to the persons on the attached service list.

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